HOUSING MARKET INFORMATION

HOUSING MARKET ASSESSMENT

Victoria CMA

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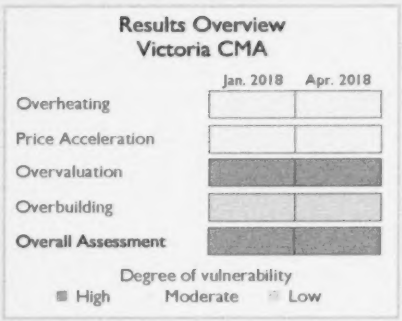
Canada

CMHC SCHL

Highlights



- The HMA framework detected a high degree of housing market vulnerability in Metro Victoria[1].
- The affordability of homes worsened in the fourth quarter of 2017.
- Supply remains low in Metro Victoria, but there is a growing inventory of new homes.

HMA Overview[2]

As Canada's authority on housing, CMHC contributes to market stability by providing information on potential imbalances that could affect housing markets. With the Housing Market Assessment (HMA), CMHC offers information and analysis that can help Canadians make more informed decisions.

The HMA combines the results from a technical framework with insights gained through CMHC's Market Analysts' knowledge of local market conditions. These insights position CMHC to provide additional context and interpretation to the results of the HMA framework.

The HMA framework detects degrees of vulnerability in local housing markets by identifying imbalances. An example would be the detection of overbuilding, a situation in which the inventory of unsold new homes accumulates due to supply outpacing demand. Such an imbalance could be resolved by an adjustment in house prices. As an example, lower prices would help resolve an excess supply imbalance by supporting stronger demand and/or reducing supply. However, other unexpected developments that do not originate from the housing market could accentuate or reduce an imbalance.

Colour codes indicate the degree of market vulnerability. The HMA is a comprehensive framework that considers both the intensity of signals of imbalances (that is, how far the indicator is from its historical average) and the persistence over time. Generally, low intensity and persistence are associated with low evidence of vulnerability. As the number of intense and persistent signals increases, the associated degree of vulnerability becomes stronger.

In Detail

Overheating

There was moderate evidence of overheating in the fourth quarter of 2017. The sales-to-new-listings ratio (SNLR) was 69%, below the threshold of 80%. However, a clear trend awayfrom threshold has not been established. The market remains out of balance, as the typical range for a balanced market is between 50 to 70%.

In March 2018, the SNLR was above the threshold for apartment and townhouse units, and trended up to 75% for single-detached units. While there are certain segments of the market that favour the sell-side more strongly, the overall market remains overheated. As of this

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[1] Results are based on data as of the end of December 2017 and market intelligence as of the end of March 2018. CMHC continuously monitors market developments and will issue HMA updates on a quarterly basis.

[2] A detailed description of the framework is available in the appendix of the National edition.

report, there is little evidence that the market has moved toward balanced market conditions.

Price Acceleration

Moderate evidence of price acceleration was detected in Metro Victoria for the seventh consecutive quarter. Since the second quarter of 2015, the average MLS® price in Metro Victoria increased at a rapid rate.

In the fourth quarter of 2017 average MLS® price growth slowed to 8% year-over-year. In Figure 2, the price acceleration indicator shows that price growth receded below threshold in the third and fourth quarters of 2017. However the rating is maintained. The test for price acceleration uses a three-year window to assess periods of rapid price growth, when the test moves below threshold there is a cooling-off period before the rating returns to green.

Overvaluation

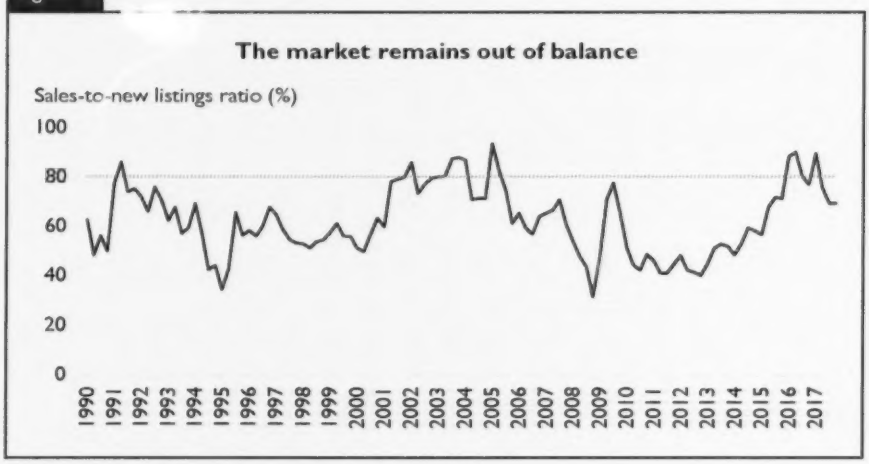
The HMA framework detected high evidence of overvaluation in Metro Victoria for the fourth consecutive quarter. Figure 3 shows both the average of all overvaluation models used as well as the model with the strongest signal of overvaluation, as multiple models are considered in the assessment.

In the fourth quarter of 2017, one of the models which signals overvaluation included a calculation of the carrying cost, explicitly. In other words, long-term affordability trends were one of the indicators of overvaluation in Metro Victoria. Recent increases in the mortgage rate have increased the carrying cost of a mortgage, hence lowering affordability. Whereas, models of supply and demand derived from economic conditions like employment and population growth were more aligned with the level of price growth for the fourth quarter of 2017.

Braden Batch
Senior Market Analyst

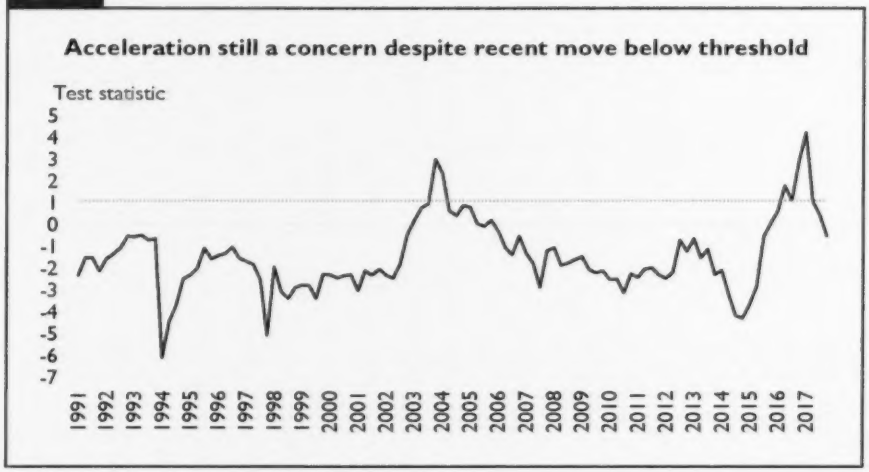
"The Metro Victoria housing market continued to show a high degree of vulnerability. Despite a slower rate of price growth, there was reduced affordability on rising interest rates as well as persistent low supply."

Figure 1



Sources: CREA and calculations (threshold) by CMHC

Figure 2

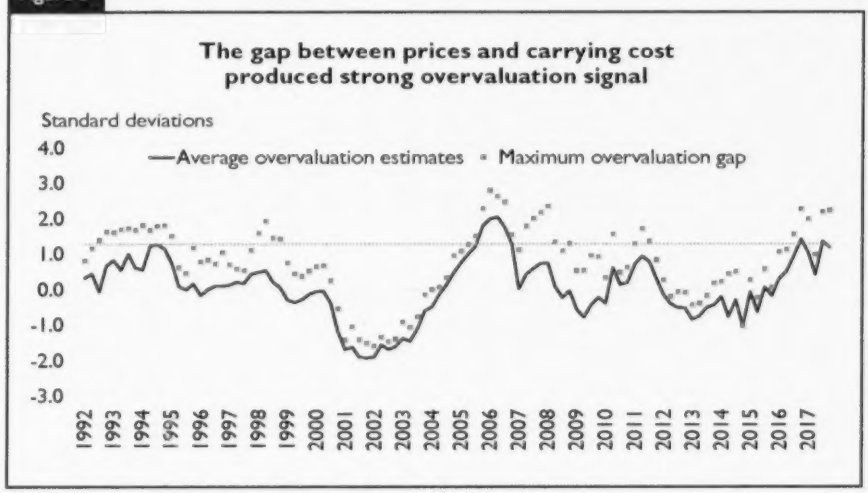


Sources: CREA and calculations by CMHC

Overbuilding

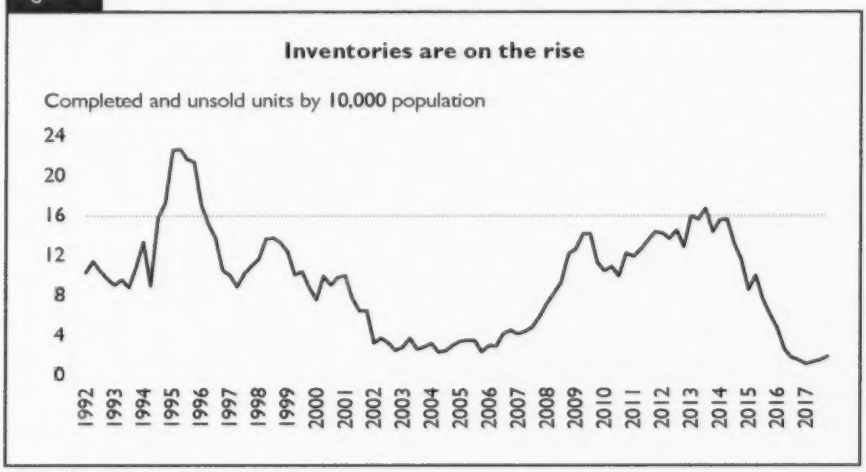
The HMA framework detected low evidence of overbuilding in the Metro Victoria housing market in the fourth quarter of 2017. However, inventory levels are now on the rise. At the end of 2017 complete and unsold units numbered 73 units, nearly double the inventory of 37 units in the first quarter of 2017. Strong multi-family construction showed only a modest increase in the apartment vacancy rate from 0.5% in October 2016 to 0.7% in the same month of 2017. Both measurements indicated low supply rather than overbuilding.

Figure 3



Sources: CREA, Statistics Canada and calculations by CMHC.
Note: A standard deviation larger than 1.29 is considered as significant. 10 per cent of observation are above the threshold.

Figure 4



Sources: Statistics Canada and CMHC

Overview of the Housing Market Assessment analytical framework

To obtain an accurate picture of the overall state of the housing market, it is important to consider multiple data points and lines of evidence rather than relying on just one measure or indicator.

The Housing Market Assessment (HMA) analytical framework provides a comprehensive and integrated view that relies on a combination of signals from several indicators to detect imbalances in housing markets.

Specifically, the framework considers four main factors that may provide an early indication of vulnerability in the housing market: (1) overheating (when demand outpaces supply); (2) sustained acceleration in house prices; (3) overvaluation of house prices in comparison to levels that can be supported by housing market fundamentals (listed below); and, (4) overbuilding (when the inventory of available housing units is elevated).

For each factor, the framework tests for: (1) the incidence of signs of vulnerability, but also considers; (2) the intensity of the signals, i.e. how their magnitude compares with their historical average or how consistent they are with known or suspected house price bubbles, such as for Toronto in the late 1980s and early 1990s; and, (3) the persistence of signals over time.

Generally, a situation in which we detect few signals with low intensity or lack of persistence is associated with a low degree of vulnerability. Conversely, as the intensity, number, and/or persistence of the signals increases, so does the evidence of imbalances in the housing market.

The framework takes into account demographic, economic, and financial determinants of the housing market such as population, personal disposable income, and interest rates to detect vulnerability. The framework also takes into account developments in both resale and residential construction markets.

The framework was developed on the basis of its ability to detect vulnerable housing market conditions in historical data, such as the house price bubble Toronto experienced in the late 1980s and early 1990s. The ability of the HMA to detect vulnerabilities relies on the assumption that historical relationships between prices and fundamental drivers of housing markets have not changed.

Housing Market Assessment Factors

Overheating

Overheating is caused by demand significantly and persistently outpacing the supply of housing. The sales-to-new listings ratio is used as an indicator to assess possible overheating conditions in the existing home market. To identify signs of overheating, the framework compares the sales-to-new listings ratio to thresholds. When demand is strong relative to supply, house prices typically grow at a faster rate. Sustained overheating on the existing home market may lead to acceleration in house prices for existing and new homes. However, as supply and demand begin to balance out, indicators of overheating (and acceleration) would begin to soften and house prices would gradually moderate.

Acceleration in House Prices

Under balanced market conditions, house prices are expected to increase over time, in line with increases in households' cost of living. House price acceleration occurs when the growth in house prices strengthens over time on a persistent basis. Acceleration in house prices over an extended period can cause their pace of increase to depart from the overall price inflation and eventually lead to overvaluation.

To assess acceleration in house prices, the HMA framework uses a statistical test* that was developed to identify periods of accelerating asset prices.

Overvaluation

Overvaluation is detected when house prices remain significantly above the levels warranted by fundamental drivers of housing markets such as income, population, and actual and expected financing costs.

The HMA framework uses combinations of different house price measures and models to estimate house price levels warranted by fundamental drivers. The difference between observed house prices and their estimated levels consistent with housing market fundamentals allows for an estimation of the degree of over- and undervaluation. The use of different price measures and models improves the reliability of results.

Overbuilding

Overbuilding is detected when the supply of readily available housing units significantly exceeds demand. In such a context, downward pressure on house prices would occur until the excess supply is eventually absorbed. To assess signs of overbuilding in the housing market, the HMA framework uses two indicators that relate to the supply of readily available housing units: the rental vacancy rate, and the inventory of completed and unsold housing units per 10,000 population. The HMA framework compares the current level and recent trends in these indicators with thresholds.

Note 1: Colour codes indicate the degree of market vulnerability. The HMA reflects a comprehensive framework that not only tests for the presence or incidence of signals of imbalances (that is, how far the indicator is from its historical average), but also considers the intensity and the persistence of these signals over time. Generally, low intensity and persistence are associated with a lower vulnerability. As the number of persistent signals increases, the evidence of an imbalance increases.

Note 2: Results at the CMA level are not segmented by housing type or neighbourhood. They represent an assessment of the entire CMA. However, specific CMA reports provide further detailed analysis of these markets.

Note 3: The colour scale extends to red only for those factors that have multiple indicators that can identify imbalances. As a result, only overvaluation and overbuilding can receive a red rating, since they are assessed using more than one indicator.

Note 4: To ensure the framework is as current as possible, on a regular basis, we undertake a model selection process whereby our house price models for overvaluation are tested for statistical significance at the national and CMA level. The result of this process may change the number of indicators showing vulnerability from the previous assessment.

* See Phillips, Wu and Yu (2008) "Explosive Behaviour in the 1990s NASDAQ When Did Exuberance Escalate Asset Values?" for further details on the methodology.

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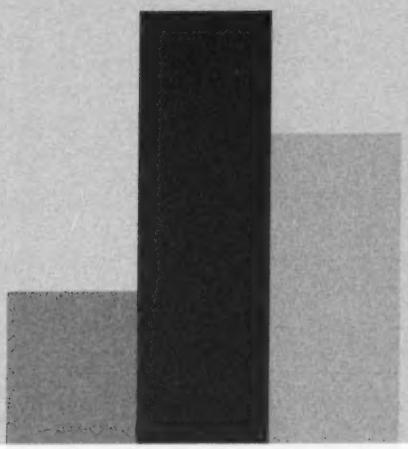

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